No. 91-611

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

KEYTON E. BARKER and PAULINE BARKER, *et al.*,
Petitioners,
v.
STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,
Respondents.

On Writ of Certiorari to the Supreme Court of Kansas

BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, COUNCIL OF STATE GOVERNMENTS, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, AND U.S. CONFERENCE OF MAYORS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a State violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity by taxing military retired pay while exempting state and local government retirement benefits.

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INTEREST OF THE *AMICI CURIAE*

Amici are organizations whose members include state, county, and municipal governments and officials throughout the United States. They and their members have a compelling interest in legal issues that affect state and local governments. Because the question presented in this case concerns the States' taxing

authority, one of the principal attributes of state sovereignty, *amici* submit this brief to assist the Court in the resolution of this case.[1]

STATEMENT

Amici adopt respondents' statement of the case.

SUMMARY OF ARGUMENT

1. The power to tax is one of the principal attributes of state sovereignty. The creation of tax classifications is integral to this power. *See Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547 (1983). The intergovernmental tax immunity doctrine does not nullify this area of state sovereignty, but establishes a discrete, narrow limitation upon it. As a general matter the United States consents to the taxation of pay or compensation of federal employees; it is only when "the taxation . . . discriminate[s] . . . because of the source of the pay or compensation" that consent is inoperative. *See* 4 U.S.C. § 111; *Davis v. Michigan Department of the Treasury*, 489 U.S. 803, 809 (1989).

The purpose of the intergovernmental tax immunity doctrine is to prevent one government from interfering with the operations of another government. The doctrine does not confer preferential tax treatment on individuals or classes of taxpayers merely because they happen to be federal employees. *See Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 486 (1939). Petitioners are flatly in error when they argue that whenever a State confers favorable tax treatment on *any* retired state employees,

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[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of the Court.

the doctrine requires the State to confer identical tax treatment on *every* federal retiree. On the contrary, differential tax treatment of classes of taxpayers is permissible provided "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Davis*, 489 U.S. at 816 (citation omitted).

2. Kansas's differential tax treatment of the benefits of federal military retirees and retired state and local government employees satisfies the requirements of the intergovernmental tax immunity doctrine and Section 111. Military retired pay is properly characterized as reduced current compensation for reduced current services because of the continuing obligations of and restrictions upon retired military personnel. Retired state and local government employees are subject to no comparable obligations or restrictions. Furthermore, all state and local employees must contribute to their retirement; because Congress fully funds military retired pay, no military personnel do so. The fact that military retired pay and state and local pension benefits are, in certain particulars, treated similarly for federal income tax purposes is irrelevant to the validity of the Kansas tax scheme.

ARGUMENT

I. THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE DOES NOT NULLIFY THE BROAD POWER OF THE STATES TO CREATE CLASSIFICATIONS IN TAX STATUTES

This case, which challenges income tax classifications drawn by the Kansas legislature, goes to the heart of one of the principal attributes of state sovereignty. "The power of a state to tax [is] basic to its sovereignty." *Bode v. Barrett*, 344 U.S. 583, 585 (1953). As this Court has "often stated[,]. . . . [t]he States have a very wide discretion in the laying of their taxes." *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526 (1959).

State legislatures accordingly "have especially broad latitude in creating classifications and distinctions in tax statutes." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547 (1983); *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973).

> "The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized. . . . [T]he passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. Traditionally classification has been a device for fitting tax programs to local needs and usages in order to achieve an equitable distribution of the tax burden. It has, because of this, been pointed out that in taxation, even more than in other fields, legislatures possess the greatest freedom in classification."

Regan, 461 U.S. at 547 (quoting *Madden v. Kentucky*, 309 U.S. 83, 87-88 (1940)).

Consistent with principles of state sovereignty, the intergovernmental tax immunity doctrine, codified in 4 U.S.C. § 111, has a very circumscribed function. It establishes a discrete, narrow limitation on what is otherwise a vital area of state authority. Section 111 expresses the consent of the United States to the taxation of pay or compensation of federal employees, provided only that "the taxation does not discriminate . . . because of the source of the pay or compensation." 4 U.S.C. § 111; *see Davis*, 489 U.S. at 809. A tax "not directly laid on the Federal Government . . . is valid if nondiscriminatory or until Congress declares otherwise." *United States v. County of Fresno*, 429 U.S. 452, 460 (1977) (citation omitted).

The purpose of the doctrine is to prevent one government from using its tax laws to interfere with the operations of another government. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 481 (1939); *Helvering v. Gerhardt*, 304 U.S. 405, 421 (1938). Nondiscrimination is not an end in itself, but is rather a means of "policing" compliance with the doctrine and ensuring that its purposes are served. *See* U.S. Br. 7-8. "The only right that a taxpayer can assert against the state taxing power on the basis of governmental immunity is a 'derivative one.'" *City of Detroit v. Murray Corp.*, 355 U.S. 489, 503 (1958) (opinion of Frankfurter, J.) (quoting *James v. Dravo Contracting Co.*, 302 U.S. 134, 158 (1937)). Any such protections derive from and must be justified by the necessity of protecting the federal government from disparate tax treatment that interferes with its operations.

It is not a purpose of the doctrine, however, to make persons who deal with the United States a

favored class to whom States are *required* by federal law to give preferential tax treatment. Petitioners are in error when they assert (Br. at 13) that whenever a State confers favorable treatment on *any* class of retired state employees, it must confer identical tax treatment on *every* federal retiree. Justice Stevens has explained that "[t]he intergovernmental immunity doctrine simply does not constitute a most favored nation provision requiring the States to accord federal employees and federal contractors the greatest tax benefits that they give any other group subject to their jurisdiction." *Davis*, 489 U.S. at 823 (Stevens, J., dissenting). Neither petitioners nor their *amici* acknowledge this principle or the need to limit the intergovernmental tax immunity doctrine to prevent it from eviscerating the States' sovereign authority to create classifications for tax purposes.

Section 111, which embodies the modern doctrine of intergovernmental immunity, "[i]n effect . . . simply codified the result in *Graves*." *Davis*, 489 U.S. at 812. *Graves*, which held that States may tax federal employees' income, turned upon two important principles that are relevant here. First, the States have a strong sovereignty interest in being able to tax. *Graves*, 306 U.S. at 487. Second, federal employees do not themselves have a constitutionally protected interest in avoiding state taxation; any such protection they receive derives from the doctrine's core concern, *i.e.*, precluding state taxation that interferes with government operations:

> [T]he expansion of the immunity of the one government correspondingly curtails the sovereign power of the other to tax, and where that immunity is invoked by the private citizen it tends

> to operate for his benefit at the expense of the taxing government and without corresponding benefit to the government in whose name the immunity is claimed. . . . [A]s applied to the taxation of salaries of the employees of one government, the purpose of the immunity is not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government. . . but to prevent undue interference with the one government by imposing on it the tax burdens of the other.

Id. at 483-84 (citation and footnote omitted)

Section 111 was enacted immediately after *Graves* was decided. Congress retained *Graves*'s focus on protecting the federal government rather than granting preferential tax status to federal employees. The purpose of § 111 is "[t]o protect the Federal Government against the unlikely possibility of State and local taxation of compensation of Federal officers and employees which is aimed at, or threatens the efficient operation of, the Federal Government." H.R. Rep. No. 26, 76th Cong., 1st Sess., 5 (1939); S. Rep. No. 112, 76th Cong., 1st Sess., 12 (1939).

Section 111 and the constitutional doctrine it codifies are thus very narrow. Nobody would suggest, for example, that a State could provide its blind residents with a tax exemption only if it provided the same exemption to all federal employees and retirees. *See Davis*, 489 U.S. at 821-22 (Stevens, J., dissenting). Similarly, a State might exempt the pension benefits of disabled state and local firefighters without exempting the retirement benefits of all federal employees. Such an exemption would certainly have a differential impact on federal employees, and by pro-

viding more favorable tax treatment to a class of state and local retirees it could be asserted to discriminate against federal retirees. But the difference in tax treatment plainly would be a result of affirmative state tax policy, rather than discrimination directed at the federal source of compensation.

For these reasons, it is important for the Court to bear in mind in this case, as it did in *Graves*, that too broad a reading of immunity would "impose to an inadmissible extent a restriction on the taxing power which the Constitution has reserved to state governments." *Graves*, 306 U.S. at 487. Applying these principles, *Davis* held that a State discriminates "because of" a federal source of pay or compensation when it favors a class of those who deal with the State over an identical class of those who deal with the federal government. The facts in *Davis* dictated this result. The classes of state and federal government retirees that were subjected to different tax treatment were identical in all ways but one—one class had retired from the state government while the other had retired from the federal government. *See Davis*, 489 U.S. at 805-06. Because there were no "significant differences between the two classes" this inconsistent tax treatment was impermissible source-based discrimination.[2]

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[2] The Court understandably rejected the State's proffered justifications for the inconsistent treatment. First, the State's purpose for providing a tax benefit to retirees—hiring and retaining qualified workers—was irrelevant to demonstrating that there were significant differences between the two classes. *Davis*, 489 U.S. at 816. Second, the State's argument that its benefits were less generous than federal benefits was subject to many exceptions. Hence, the State's justification was not based upon a difference that defined the classes by being true

Here, in contrast to *Davis*, the differences between the classes are, as found by the courts below, substantial. The question presented is whether differential tax treatment is "directly related to and justified by" these differences. *Davis*, 489 U.S. at 816. In making this determination the Court must elaborate upon its analysis in *Davis* in a manner that will both serve the purpose of the intergovernmental tax immunity doctrine and preserve the States' sovereign authority to classify for tax purposes. This is a suitable occasion for doing so since, as detailed in Respondents' Brief (at 4-5 n.3), taxation of military retired pay has been the subject of intensive and prolonged deliberation by the Kansas legislature. A determination that the scheme arrived at by the Kansas legislature is invalid would, *amici* submit, constitute an unwarranted judicial invasion of the State's sovereign authority to draw classifications for tax purposes.

II. DIFFERENTIAL TAX TREATMENT OF FEDERAL MILITARY RETIREES AND RETIRED STATE AND LOCAL GOVERNMENT EMPLOYEES IS DIRECTLY RELATED TO AND JUSTIFIED BY SIGNIFICANT DIFFERENCES BETWEEN THE CLASSES

In contrast to the Michigan tax scheme at issue in *Davis*, the Kansas tax scheme does not tax the retirement benefits of all federal retirees. The retirement benefits of the class of retired federal employees that is similarly situated to Kansas state and local government retirees are exempt from Kansas

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for each and every member of the classes. *Id.* at 816-17; *see Billings v. Illinois*, 188 U.S. 97, 104 (1903) (A tax "classification . . . has relation to [a legislative] purpose [if it] excludes no persons or objects that are affected by the purpose [and] includes all that are.").

income tax. *See* Pet. App. 29a; Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990) (subtracting from Kansas adjusted gross income "[a]mounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund").[3] The retirement benefits received by federal military retirees are not exempt from Kansas income tax, however. This differential treatment of petitioners' class is, as *Davis* requires, directly related to and justified by significant differences between that class and the class of Kansas state and local government retirees.[4]

The court below based its holding on the conclusion that military retired pay, unlike the retirement pay of Kansas state and local government retirees, "is reduced current compensation for reduced current services." Pet. App. 30a. As demonstrated by respondents (Br. at 11-15), this conclusion is fully sup-

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[3] Kansas also exempts benefits paid under the Railroad Retirement Act. *See* Kan. Stat. Ann. § 79-32,117(c)(viii) (Supp. 1990). *See generally* Resp. Br. 24 n.15 (discussing federal retirement benefits exempted from Kansas tax).

[4] Analysis of the validity of the tax is naturally concerned with its actual workings, not its form. As this Court stated in a closely related circumstance,

> in passing on the constitutionality of a state tax we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it. Consequently, in determining whether these taxes violate the Government's constitutional immunity we must look through form and behind labels to substance. This is at least as true to uphold a state tax as to strike one down. Due regard for the State's power to tax requires no less.

City of Detroit v. Murray Corp., 355 U.S. at 492-93 (citations and internal quotation omitted).

ported by the continuing obligations of and restrictions upon retired military personnel. See *McCarty v. McCarty*, 453 U.S. 210, 221-22 (1981).[5] It is also squarely in accord with the determinations of this Court and the lower federal courts. *See id.* at 222 ("military retired pay is reduced compensation for reduced current services"); *United States v. Tyler*, 105 U.S. 244, 245 (1882) (military retired pay is "compensation . . . continued at a reduced rate"); *Cornetta v. United States*, 851 F.2d 1372, 1382 (Fed. Cir. 1988) ("Retired pay is reduced pay for reduced current services.") (citing *Hostinsky v. United States*, 292 F.2d 508, 510 (Ct. Cl. 1961)).

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[5] In *McCarty* the Court reaffirmed that:

> "It is impossible to hold that men who are by statute declared to be part of the army, who may wear its uniform, whose names shall be borne upon its register, who may be assigned by their superior officers to specified duties by detail as other officers are, who are subject to the rules and articles of war, and may be tried, not by a jury, as other citizens are, but by a military court-martial, for any breach of those rules, and who may finally be dismissed on such trial from the service in disgrace, are still *not* in the military service."

453 U.S. at 221 n.13 (quoting *United States v. Tyler*, 105 U.S. 244, 246 (1882)).

See also Kahn v. Anderson, 255 U.S. 1, 6-7 (1921) ("it is not open to question . . . that [retired] officers are officers in the military service of the United States"); *Puglisi v. United States*, 564 F.2d 403, 410 (Ct. Cl. 1977), *cert. denied*, 435 U.S. 968 (1978); *Hooper v. United States*, 326 F.2d 982, 987 (Ct. Cl. 1964) (officer's retired pay is "not solely recompense for past services, but a means devised by Congress to assure his availability and preparedness in future contingencies . . . [since retired officer] formed a part of a vital segment of our national defense"), *cert. denied*, 377 U.S. 977 (1964).

In this respect, the differences between retired state and local government employees and retired military personnel could not be more stark. While retired military personnel "may be ordered into active duty" at any time, U.S. Br. 12 & n.20 (citing 10 U.S.C. § 688 (a)); *see also McCarty*, 453 U.S. at 222, there is no remotely similar obligation for any retired Kansas employees. Indeed, the sole category of retired state employees identified by petitioners as subject (under any circumstances) to returning to work—retired members of the judiciary, *see* Pet. Br. 24—do so only on an entirely voluntary basis. *See* Kan. Stat. Ann. § 20-2616 (1988) (retired members of judiciary "may be designated and assigned to perform such judicial service and duties *as such retired justice or judge is willing to undertake*") (emphasis added).

Another significant difference exists in the way Kansas retirement benefits and military retired pay are funded. State and local employees make contributions toward their retirement. Kan. Stat. Ann. §§ 74-4919(1), 74-4921(1) (Supp. 1990). Military personnel do not contribute to their retirement, and are not required to forego present use of any income, because military retired pay is fully funded by annual congressional appropriations. *McCarty*, 453 U.S. at 214; 10 U.S.C. §§ 1461-1467.[6] Military retired pay cannot be characterized as deferred com-

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[6] Petitioners argue that because retirees of the Kansas board of regents and educational institutions under its management may elect to fund their retirement "through salary reductions rather than out-of-pocket contributions," not all Kansas employees must make "contributions" to their retirement. Pet. Br. 25 & n.20. The labels one chooses do not change the fact that *all* Kansas employees must defer income to fund retirement benefits while no federal military personnel do so.

pensation—nothing has been deferred. Military retired pay and state retirement benefits are thus fundamentally different in nature, justifying their differential tax treatment. *Cf. Walters v. City of St. Louis*, 347 U.S. 231, 236 (1954) (state law could classify wage and salary income differently from profits from self-employment or business).

In an attempt to demonstrate that Kansas's treatment of military retired pay is invalid, the petitioners and the United States repeatedly refer to tax treatment of federal retirement benefits not before the Court. *See* Pet. Br. 4, 8, 17, 21, 23, nn.4, 16, 17; U.S. Br. 3-4, 17-19, nn. 27-31. They argue that the determination of whether a state tax scheme discriminates " 'requires an examination of the whole tax structure of the state.' " U.S. Br. 19 n.31 (quoting *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 383 (1960) (internal quotation and citation omitted)); *see also* Pet. Br. 16.

It is incorrect to read this language from *Phillips* as making immunity turn upon provisions that are not before the Court. In *Phillips* the Court merely found that it could not evaluate "in a vacuum" the constitutionality of state taxation of federal lessees; instead, it had to "focus on the nature of classification" at issue in the case by evaluating both the statute that authorized taxation of federal lessees and the statute that exempted otherwise identical state lessees. 361 U.S. at 383.

Other federal retirement provisions may or may not set up classes that significantly differ from the class of state and local government retirees. Since the issue was never litigated, however, it is impossible to know on this record whether they do or not. Ex-

amining other federal retirement provisions tells the Court nothing about whether the class of military retirees significantly differs from the class of Kansas retirees. This Court should not "formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied." *Ashwander v. TVA*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

Petitioners place much weight on the fact that military retired pay and state and local pension benefits are, in certain particulars, treated similarly for federal income tax purposes. *See* Pet. Br. 27-29. While petitioners contend that certain cases have stated that military retired pay is taxable as ordinary pension income when received, *see* Pet. Br. 27-28 & n.23, these cases were not deciding whether military retired pay and state and local government pension benefits are given identical treatment for all purposes under the Internal Revenue Code. Instead, they were simply stating that, as is indisputable, both military retired pay and state and local government pensions are currently subject to federal income tax as gross income under the Code since § 61(a) provides that "gross income includes all income from whatever source derived." *Strickland v. Commissioner*, 540 F.2d 1196, 1198 (4th Cir. 1976) (citing 26 U.S.C. § 61(a)). This obviously does not mean that there are no significant differences between the two, or that the two must be treated alike for tax purposes by the States.[7]

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[7] Petitioners suggest that military retired pay is treated by Congress like pension income for purposes of computing deductions for contributions to an IRA. *See* Pet. Br. 29. But since the purpose of an IRA is to enable individuals to set aside

Petitioners, in short, fail to offer any basis for upsetting the sovereign determination of the Kansas legislature to classify military retired pay and state and local government retirement benefits differently for Kansas income tax purposes.[8]

CONCLUSION

The judgment of the Supreme Court of Kansas should be affirmed.

Respectfully submitted,

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some earnings for retirement, *see* S. Rep. No. 383, 93d Cong., 1st Sess. 131 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890, "to allow an IRA deduction for contributions made with retirement pay would be inconsistent with the purpose of an IRA, regardless of whether [military] retirement pay is 'deferred compensation' or 'reduced compensation for reduced current services.'" Pet. App. 25a.

[8] To say that there is no constitutional immunity here "is not to say that Congress, acting within the proper scope of its power, cannot confer immunity by statute where it does not exist constitutionally." *United States v. City of Detroit*, 355 U.S. 466, 475 (1958).